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No. 82-500

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

THE SOUTHLAND CORPORATION, *et al.*,
Appellants,

v.

RICHARD D. KEATING, *et al.*,
Appellees.

On Appeal from the Supreme Court of California

REPLY BRIEF OF APPELLANTS

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REPLY BRIEF OF APPELLANTS

A. This Court Has Jurisdiction

1. *Appellees' Argument Concerning the Scope of the Parties' Arbitration Agreement Is Not Before the Court, and, in Any Event, Is Meritless*

Appellees contend that this Court lacks jurisdiction because the arbitration clause in the 7-Eleven franchise agreement allegedly is not broad enough to cover claims under the California Franchise Investment Law.[1] This

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[1] In this brief, "Appellees' Br." refers to the Brief of Appellees, "Appellants' Br." refers to the Brief of Appellants, "J.S. App." refers to the Appendix to the Jurisdictional Statement, and "J.A." refers to the Joint Appendix.

argument is not properly before the Court, for it was neither raised by appellees in the California Supreme Court nor considered by that court in its decision. The California Court of Appeal rejected appellees' argument concerning the scope of the arbitration clause (J.S. App. 65a-66a), and appellees elected not to challenge that ruling further.[2] Under California law, the point was deemed to have been abandoned.[3] Therefore, appellees are precluded from raising the issue anew in this Court.[4]

In any event, appellees' scope-of-the-arbitration-clause argument does not affect this Court's *jurisdiction* under 28 U.S.C. § 1257(2) (1976) to consider the issues raised in Southland's Jurisdictional Statement. At most, the issue goes to the *merits* of whether Southland is entitled to demand arbitration in this case. The authority cited by appellees in support of their "jurisdictional" argument, *Iowa Beef Packers, Inc.* v. *Thompson*, 405 U.S. 228 (1972) (per curiam), is not on point. In that case the Court dismissed a writ of certiorari, not because jurisdiction was lacking, but because the issue as to which the Court had granted discretionary review could not properly be addressed given the narrow scope of the

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[2] In the trial court, the judge had ruled *sua sponte* that the arbitration clause in the 7-Eleven franchise agreement was not broad enough to apply to statutory claims. The franchisees attempted to support that ruling in the California Court of Appeal, albeit on different grounds than they advance here. In this Court, appellees' argument is that arbitration is inappropriate because the franchise agreement does not require arbitration when "prohibited by applicable law" (*see* Appellees' Br. 6-11); this argument was not made by appellees in the California Court of Appeal. (*See* Respondents' Brief, Cal. Ct. App., June 4, 1979, at 17-22.)

[3] *See, e.g., Long* v. *California-Western States Life Ins. Co.*, 43 Cal. 2d 871, 279 P.2d 43, 50 (1955); *Title Guarantee & Trust Co.* v. *Fraternal Finance Co.*, 220 Cal. 362, 30 P.2d 515, 515 (1934). *See also* 6 B. Witkin, *California Procedure* § 425, at 4391-93 (2d ed. 1971).

[4] *See, e.g., Edelman* v. *California*, 344 U.S. 357, 358 (1953); *Hulbert* v. *City of Chicago*, 202 U.S. 275, 281 (1906).

parties' agreement to arbitrate. The arbitration clause in *Iowa Beef* was expressly limited to alleged violations of the agreement itself, whereas the grievance at issue pertained to an independent and separate claim under statutory law. There is no similar limitation on the face of the arbitration agreement now before the Court.[5]

In any event, the interpretation of the 7-Eleven arbitration clause being urged by appellees begs the question before the Court. Appellees point out that the agreement does not require arbitration where arbitration is "prohibited by applicable law," and they argue that the California Franchise Investment Law is the "applicable law." However, as appellees concede, the Federal Arbitration Act is also "applicable," and one of the ultimate issues to be decided by this Court is whether California can lawfully prohibit arbitration of claims where the federal statute applies. In other words, appellees are asking this Court, in the guise of a "jurisdictional" argument, to decide in their favor the underlying merits of this appeal. This would be contrary to this Court's longstanding rule that it determines the existence of jurisdiction *before* reaching the merits and not on the basis of who is correct as to the merits.[6]

Finally, appellees' narrow reading of the 7-Eleven arbitration clause is contrary to the policy of the Federal

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[5] Whereas the arbitration clause involved in *Iowa Beef* was limited to grievances " 'pertaining to a violation of the Agreement,' " 405 U.S. at 229-30, the 7-Eleven arbitration agreement covers all controversies "arising out of or relating to this Agreement or the breach hereof," except where arbitration is "prohibited by applicable law." (*See* J.S. App. 49a n.2.)

[6] *See, e.g., Hagans* v. *Lavine*, 415 U.S. 528, 542-43 & n.10 (1974); *Ex parte Watkins*, 32 U.S. (7 Pet.) 568, 572 (1833).

Appellees likewise beg the question before the Court when they argue that there is no federal question because state protective legislation—such as the California anti-arbitration law before the Court—"was never intended, and does not, fall within the coverage of the [Federal Arbitration] Act." (Appellees' Br. 17.)

Arbitration Act, which "requires a liberal reading of arbitration agreements," *Moses H. Cone Memorial Hospital* v. *Mercury Construction Corp.*, 103 S. Ct. 927, 941 n.27 (1983), and which "establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability." *Id.* at 941-42. *Accord, United Steelworkers* v. *Warrior & Gulf Navigation Co.*, 363 U.S. 574, 582-83 (1960). The agreement at issue in this case broadly calls for arbitration of *any* claim relating to the franchise relationship except to the extent that arbitration is *prohibited*. Where, as here, the exclusion clause is narrow and the arbitration clause quite broad, only the "most forceful evidence" of a specific exclusion of a particular claim will result in a decision that the claim is not within the scope of the arbitration clause. *United Steelworkers* v. *Warrior & Gulf Navigation Co.*, 363 U.S. at 584-85. There is no such evidence here.

2. *The Class Arbitration Issue Was Raised and Litigated in the California Courts*

Appellees claim that Southland did not raise the class arbitration question as a federal issue in the court below. (Appellees' Br. 11-13.)[7] Southland has already answered most of appellees' arguments concerning this claim. (*See* Appellants' Br. 21-23.)

Appellees contend that Southland conceded in the California Court of Appeal that state law, as opposed to federal law, controlled the class arbitration issue. (Appellees' Br. 12.) This is incorrect. The Clerk of the California Court of Appeal asked the parties to indicate

[7] Appellees do not contend that the other issue presented by this appeal was not raised and litigated below. (*See* Appellants' Br. 20 n.21.)

in their briefs whether Rules 23 and 81(a)(3) of the Federal Rules of Civil Procedure provided authority for ordering the arbitration to proceed as a class action.[8] Southland responded in the negative on the ground that Rule 81[9] only makes the Federal Rules applicable to judicial proceedings relating to arbitration (*e.g.*, suits to compel arbitration or suits to enforce an arbitral award) and does not make the Rules applicable to the arbitration itself (which would be the case if a court directed an arbitration to proceed as a class action under Rule 23).[10] Southland added in a footnote that, in any event, the Federal Rules of Civil Procedure are inapplicable in the state courts and that "California state courts normally apply their own procedural rules in *litigation* involving a federal substantive right, *provided that such application does not result in the violation of a federal right.*"[11] Southland also stated (i) that class action procedures would be inconsistent with the basic purposes and procedures of arbitration, (ii) that there was no authority for class action procedures under federal law, state law, or the rules of the American Arbitration Association, and (iii) that a class action arbitration would pose serious problems under the due process clause of the United States Constitution.[12] Southland reiterated

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[8] *See* Letter to Counsel from Office of the Clerk, Cal. Ct. App., May 18, 1979.

[9] Fed. R. Civ. P. 81(a)(3) provides, in pertinent part, that "[i]n proceedings under Title 9, U.S.C., relating to arbitration . . . , these rules only apply to the extent that matters of procedure are not provided for in those statutes."

[10] *See* [Southland's] Supplemental Memorandum of Points and Authorities in Opposition to Petition for Writs of Mandate or Prohibition, and Reply Brief, Cal. Ct. App., July 2, 1979, at 21.

[11] *Id.* at 21 n.15 (emphasis supplied).

[12] *Id.* at 16-25.

these points in the California Supreme Court.[13] Moreover, in both the Court of Appeal and the Supreme Court it was conceded by all parties that the Federal Arbitration Act was applicable.[14] Thus, it is wrong to suggest, as appellees do in their brief, that Southland conceded that the class arbitration issue was "governed by state law." (Appellees' Br. 12.)[15]

3. *The Decision Below Is a Final Judgment*

Appellees argue that there is no final judgment as to one of the two issues presented, namely the class arbitration issue.[16] They fail, however, to address the criteria set forth in *Cox Broadcasting Corp.* v. *Cohn*, 420 U.S. 469 (1975), and *Cohen* v. *Beneficial Industrial Loan Corp.*, 337 U.S. 541 (1949). They furthermore fail to acknowledge the cases exemplified by *Mercantile National Bank* v. *Langdeau*, 371 U.S. 555, 558 (1963), which hold that important questions concerning the proper forum for the resolution of a category of disputes can and should, in circumstances similar to those here, be reviewed by

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[13] *See* [Southland's] Petition for Hearing, Cal. S. Ct., Oct. 7, 1980, at 2, 6-22.

[14] *See* Petitioner's Supplemental Memorandum in re Arbitration in a Class Action, Cal. Ct. App., July 10, 1979, at 7; Petition for Hearing at 6 n.6. *See also* J.S. App. 4a-5a, 52a.

[15] In any event, even if Southland had failed in the state courts to present the class action issue as a broad federal question, this Court would nonetheless have jurisdiction to consider the issue now given the fact that "matters of basic principle are at stake." *See Lear, Inc.* v. *Adkins*, 395 U.S. 653, 662 n.10 (1969).

[16] Appellees virtually concede that there is a final judgment as to the California Franchise Investment Law issue. They did not challenge the finality of this issue in their Motion to Dismiss this appeal. (*See id.* at 5, 6-7.) Their only reference to this question in their brief on the merits is a bootstrap argument that this Court lacks jurisdiction because the Franchise Investment Law is not preempted by the Federal Arbitration Act. (*See* Appellees' Br. 17.) This "jurisdictional" argument is without merit. *See supra* note 6.

this Court prior to the completion of judicial proceedings. (*See* Appellants' Br. 16-17.)

Appellees' principal argument is that the ruling on the class arbitration issue is not "final" because Southland may yet be able to convince the trial court—after many additional months of class action discovery and briefing—to refrain from certifying a class in this particular case. (*See* Appellees' Br. 14.) As noted in Southland's opening brief, however, the delays and obstructions caused by judicial class action proceedings would themselves violate the policy of the Federal Arbitration Act—even if Southland were ultimately successful in those proceedings—since Southland would effectively lose the benefits of arbitration by being forced to engage in a lengthy, expensive, *judicial* procedure. (*See* Appellants' Br. 19-20.) Appellees' argument also overlooks the fact that the California Supreme Court's decision attempts to establish an important new rule of law that would not only affect this case, but arbitration generally. Thus, immediate review is warranted because, if Southland were to prevail in the further judicial proceedings, "there would remain in effect the unreviewed decision of the State Supreme Court" that class action arbitration proceedings may routinely go forward in the courts. *Cox Broadcasting Corp.* v. *Cohn*, 420 U.S. at 485.

Gillette Co. v. *Miner*, 103 S. Ct. 484 (1982) (per curiam), upon which appellees rely, is inapposite. The issue in *Gillette* was whether a class action in a state court must be limited to a statewide, as opposed to a nationwide, class. *See Miner* v. *Gillette Co.*, 87 Ill. 2d 7, 56 Ill. Dec. 886, 428 N.E.2d 478 (1981). This Court properly dismissed the petition for certiorari for lack of a final judgment since judicial procedures—indeed, judicial class action procedures—would go forward regardless of how the issue presented in the petition was resolved. The only question presented in *Gillette* concerned the *scope* of the class in an ongoing judicial

action, and any error in the state court's interlocutory ruling on that matter could easily be addressed at the conclusion of the litigation, without irreparably injuring the defendant's rights in the interim.

In the case at bar, the situation is quite different. The issue here does not concern the scope of a class in a proceeding that is destined to go forward in the courts in any event; rather, the question is whether judicial class action procedures should be available *at all* given "the unmistakably clear congressional purpose that the arbitration procedure . . . be speedy and not subject to delay and obstruction in the courts." [17] Moreover, failure to review now the California Supreme Court's ruling will mean the effective loss of the federal right of arbitration. There was no similar potential loss in *Gillette*.[18]

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[17] *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 (1967). *Accord, Moses H. Cone Memorial Hosp.* v. *Mercury Constr. Corp.*, 103 S. Ct. at 940 ("Congress's clear intent, in the Arbitration Act, [is] to move the parties to an arbitrable dispute out of court and into arbitration as quickly and easily as possible").

[18] Southland also pointed out in its opening brief that the California Supreme Court's disposition of the class action issue is appealable because that issue was decided in the procedural context of a separate proceeding for a writ of mandate or prohibition. (Appellants' Br. 18 & n.18.) Appellees dispute this, erroneously relying on *Runyan* v. *California*, 439 U.S. 904 (1978). (Appellees' Br. 16-17.) The reliance on *Runyan* is misplaced. This Court rendered no opinion in *Runyan*, and the Court's summary disposition of the appeal is of little precedential value in this Court. *See Edelman* v. *Jordan*, 415 U.S. 651, 671 (1974). There is no indication in *Runyan* that the Court intended to alter the "well settled" rule that a state court's final disposition of a writ of prohibition is a final judgment reviewable under 28 U.S.C. § 1257. *See Rescue Army* v. *Municipal Court*, 331 U.S. 549, 565-66 (1947).

Moreover, the issue in *Runyan* simply involved a question regarding pretrial discovery, and the judicial proceedings were going to continue in the trial court regardless of how the discovery issue was resolved by this Court. *See People* v. *Municipal Court* [*Runyan*], 20 Cal. 3d 523, 143 Cal. Rptr. 609, 574 P.2d 425 (1978). By contrast, the issue in the case at bar is whether the trial court has jurisdiction to conduct further judicial proceedings.

B. Where Interstate Commerce Is Involved, the Federal Arbitration Act Preempts State Legislation Purporting To Invalidate Arbitration Agreements

Most of appellees' arguments concerning the validity of the anti-arbitration provision in the California Franchise Investment Law are answered in Southland's opening brief. The following points, however, should be noted:

1. Appellees mischaracterize the issue when they colorfully state that enforcement of the parties' agreement to arbitrate would "destroy the effectiveness of California's . . . remedial legislation" (Appellees' Br. 18-19), "cripple the exercise of state police power in a substantive area" (*id.* at 19), and permit private parties "to veto state protective legislation." (*Id.* at 33.) Nothing in the 7-Eleven arbitration agreement purports to nullify any claims that appellees might have under the Franchise Investment Law; nor does the agreement provide for biased arbitrators or one-sided procedures. The agreement provides that the rules of the American Arbitration Association shall govern the arbitration (J.S. App. 49a n.2), and these procedures are universally recognized to provide for fair decisions by neutral arbitrators.

This case clearly does *not* involve any effort by Southland or by Congress to override the substantive protections of the California Franchise Investment Law. It only concerns the *forum* in which the parties must resolve their dispute. (*See also* J.S. App. 2a.) As the United States Court of Appeals for the Seventh Circuit recently recognized in rejecting an argument identical to the one advanced by appellees herein:

> [T]he conflict we face is plainly not one of federal arbitration procedures versus [state] substantive securities regulation. The conflict is rather between two *procedural* mandates . . . . If the Arbitration Act prevails, [state] substantive securities law remains intact . . . . [T]he real field of analysis here is the set of competing federal and state policies with

> respect to *non-legal dispute resolution*, not with respect to *securities regulation*.

Kroog v. *Mait*, No. 83-1094, slip op. at 10-11 (7th Cir. July 15, 1983) (emphasis in original).

2. Appellees are incorrect when they suggest that statutory claims are *ipso facto* inappropriate for arbitration. In the cases in which this Court has held that Congress has mandated the availability of a judicial forum, it has done so only after a careful analysis of congressional intent in the particular statute involved.[19] In *Wilko* v. *Swan*, this Court recognized that the Federal Arbitration Act could be a useful tool "both in controversies based on statutes or on standards otherwise created." 346 U.S. at 432. Similarly, in *U.S. Bulk Carriers, Inc.* v. *Arguelles*, 400 U.S. 351 (1971), five Justices of this Court recognized that arbitration is not necessarily inappropriate for resolving disputes based on federal remedial legislation. *See* 400 U.S. at 374 (White, J., dissenting, in an opinion in which Justices Brennan, Stewart and Marshall joined) ("Nor . . . has there been any principle that requires contract rights to be resolved internally but directs statutorily created remedies to be presented to the court, at least where, as here, the availability of the statutory remedy rests on disputed issues that are cognizable under the arbitration clause. In fact, this Court and lower federal courts have endorsed the suitability of arbitration to resolve federally created rights."); *id.* at 366 (Harlan, J., concurring). *See also Barrentine* v. *Arkansas-Best Freight System, Inc.*, 450 U.S. at 746-53 (Burger, C.J., dissenting, in an opinion in which Justice Rehnquist joined). Indeed, the Court has explicitly held that arbitration of federal statutory claims is appropriate in some contexts. *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506 (1974).

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[19] *See, e.g., Wilko* v. *Swan*, 346 U.S. 427 (1953); *Alexander* v. *Gardner-Denver Co.*, 415 U.S. 36 (1974); *Barrentine* v. *Arkansas-Best Freight System, Inc.*, 450 U.S. 728 (1981).

3. More fundamentally, the cases cited by appellees (Appellees' Br. 26 & n.28) involved a tension between the policies of two *federal* statutes, not, as here, a direct conflict between federal legislation and a state statute. In this situation, the *Wilko* v. *Swan* "analogy" is inapt, *e.g.*, *Kroog* v. *Mait*, *supra*, slip op. at 11-12, and the state statute must give way to the strong federal policy favoring arbitration, because the Federal Arbitration Act "creates a 'body of federal substantive law'" that prevails over "'any state substantive or procedural policies to the contrary.'" *Id.* at 9 n.4 (quoting *Moses H. Cone Memorial Hospital* v. *Mercury Construction Corp.*, 103 S. Ct. at 941). *Accord*, *Klein Sleep Products, Inc.* v. *Hillside Bedding Co.*, 563 F. Supp. 904, 906 & n.2 (S.D.N.Y. 1982), *motion for reconsideration denied*, Bus. Franch. Guide (CCH) ¶ 7941, at 13,503 (S.D.N.Y. 1983); *Marley* v. *Drexel Burnham Lambert, Inc.*, No. CA-3-79-1279-D, slip op. (N.D. Tex. July 7, 1983).

Appellees cannot avoid the preemptive effect of the Federal Arbitration Act by arguing that regulation of franchising is a matter of significant concern to the states. (*See* Appellees' Br. 19-22.) For example, even in the area of state regulation of mortgages, the Court has held that the normal principles of preemption "are not inapplicable . . . simply because real property law is a matter of special concern to the States: 'The relative importance to the State of its own law is not material when there is a conflict with a valid federal law, for the Framers of our Constitution provided that the federal law must prevail.'" *Fidelity Federal Savings & Loan Ass'n* v. *Cuesta*, 102 S. Ct. 3014, 3022 (1982) (quoting *Free* v. *Bland*, 369 U.S. 663, 666 (1962)). *Accord*, *Ridgway* v. *Ridgway*, 454 U.S. 46, 54-55 (1981) (domestic relations). *See also Brown* v. *Western Ry.*, 338 U.S. 294, 296, 298-99 (1949).[20]

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[20] Nor are the appellees correct in contending that "[w]hen the Federal Arbitration Act assertedly applies, the analysis should be the same" as when state courts exclude important state statutory

4. Southland noted in its opening brief that if appellees' position is sustained, the states will be free to undermine the Federal Arbitration Act by enacting a wide range of "exceptions" to the federal statute. (Appellants' Br. 29-30.) Appellees confirm the point in their brief. They argue that the reach of the Act should be narrowly limited to "common law" disputes and should be inapplicable whenever a state enacts a "statute" prohibiting arbitration of a category of disputes. (Appellees' Br. 22-31.) The Court should reject this proposal for several reasons:

(a) Appellees fail to cite anything in the Act, its legislative history, or in the case law to support the "common law versus statute" distinction, and there is, in fact, no such authority. *See Marley* v. *Drexel Burnham Lambert, Inc., supra*, slip op. at 4.

(b) Almost every subject matter, including torts and ordinary commercial relationships, can be the object of state remedial legislation. Thus, if the states could override the Federal Arbitration Act simply by enacting legislation dealing with a matter, the reach of the federal statute could be sharply curtailed by state legislatures and courts.[21]

(c) Appellees' argument is internally inconsistent. Fundamental state policies are not only embodied in statutes. They are contained in the common law as well, such that states have often recognized that the existing common law obviates the need for enacting a statute.

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claims from state arbitration acts. (Appellees' Br. 28.) State courts are free to interpret state statutes as they wish, but are obligated to follow and not impair any applicable federal statute. U.S. Const., art. VI, cl. 2. Since the Federal Arbitration Act clearly applies here, it takes priority over any competing state legislation.

[21] Some states, to this day, regard preexisting arbitration agreements to be contrary to public policy and unenforceable, notwithstanding the applicability of the Federal Arbitration Act. *See, e.g., Ex parte Alabama Oxygen Co.*, No. 82-106, slip op. (Ala. S. Ct. as amended June 20, 1983) (per curiam).

Therefore, if the purpose of appellees' proposal is to permit the states to ban arbitration when important policies are at stake, the logic of the argument would dictate that they be permitted to prohibit arbitration of common law disputes as well.

(d) To a large extent, state statutes merely reiterate common law remedies. Some states have adopted codes in which common law causes of action have been enacted into law by the legislature.[22] In addition, remedial statutes frequently are duplicative of, or are simply elaborations on, the common law. For example, in the instant case, appellees allege that Southland violated the Franchise Investment Law by intentionally making false statements and omissions in its franchise offering circular. (J.A. 17-19.) They allege that these exact same statements and omissions also constitute common law fraud. (*Id.* at 20.)[23] Where, as here, the statutory claim duplicates a common law remedy, there is no substance to the distinction that appellees propose.[24] Moreover, appellees' proposal would allow a plaintiff to evade his contractual obligation to arbitrate merely by asserting a redundant and essentially identical claim arising under the state's statutory law.

5. Appellees advance the following syllogism in their brief. The states are free to invalidate arbitration agreements "upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2 (1976). Under general doctrines of law and equity, unlawful

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[22] *See, e.g.*, Cal. Code Civ. Proc. §§ 25-30 (West 1982); Cal. Civ. Code § 3523 (West 1970). *See also id.* § 22.2 (West 1982).

[23] Actually, appellees' "common law" fraud claim is a *statutory* claim under California law. Cal. Civ. Code §§ 1571-73 (West 1982).

[24] This Court has explicitly held that arbitrators (even if they are not lawyers) are capable of deciding, and should decide, legal issues—such as fraud in the inducement—similar to the claims advanced by appellees in this case. *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967).

agreements are unenforceable. Contracts requiring arbitration of Franchise Investment Law claims are unlawful. Therefore, Section 2 of the federal statute permits California to invalidate the arbitration agreement between appellants and appellees with respect to franchise claims. (*See* Appellees' Br. 31-32.)

Appellees' reasoning is faulty. Section 2 of the Federal Arbitration Act allows the states to refuse to enforce arbitration agreements on the basis of general principles of contract formation that are equally applicable to *all* contracts. But, where interstate commerce is involved, it does not permit them to single out arbitration agreements for special, restrictive treatment. *E.g.*, *Kroog* v. *Mait*, *supra*, slip op. at 9 n.4. In the case at bar, the state courts *rejected* all of appellees' general contract-formation arguments, such as "waiver" and "adhesion contract" (*see* J.S. App. 8a, 23a), and these rulings are not at issue in this Court. Here, appellees' argument is that the parties' arbitration contract is *inherently* unenforceable by virtue of a state statute, regardless of whether the agreement was knowingly and willingly executed by parties with legal capacity, and regardless of whether other general principles of contract formation were satisfied. Under Section 2 of the federal statute, the states are not free to invalidate arbitration agreements on this basis.[25]

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[25] *See* authorities cited in Appellants' Br. 24 & n.28, 26. This Court's decision in *Burks* v. *Lasker*, 441 U.S. 471 (1979), is also instructive. In *Burks*, federal regulation of investment companies and advisers was held to rely upon state corporate law. This Court nonetheless noted that "federal courts must be ever vigilant to insure that application of state law poses 'no significant threat to any identifiable federal policy or interest. . . .' And, of course, this means that 'unreasonable,' or 'specific aberrant or hostile state rules,' will not be applied." *Id.* at 479-80 (citations omitted). States must likewise conform their law to the Federal Arbitration Act, and California cannot evade the Act by relying upon its own "contract formation" principles.

6. Appellees state that the Federal Arbitration Act would be unconstitutional if it were interpreted to confer upon private parties "the power to veto state protective legislation." (Appellees' Br. 33-34.) This argument rests on a false premise because, as noted above, the federal statute merely relates to the forum for resolving a dispute and does not purport to nullify the underlying, state-created cause of action. *See Kroog* v. *Mait, supra*, slip op. at 10-11.

Appellees also seem to contend that it is unconstitutional for Congress to interfere with a state's control over the forum in which state-created rights may be enforced. (Appellees' Br. 34-38.) This argument was squarely rejected in *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, where the Court stated that the Federal Arbitration Act is based upon "the incontestable federal foundations of 'control over interstate commerce . . . .'" 388 U.S. at 405 (citations omitted).[26]

C. Class Action Arbitrations Would Be Inconsistent with the Federal Arbitration Act

1. *State Legislatures Cannot Declare Arbitration To Be "Unconscionable"* Per Se

Appellees suggest that Southland should not complain about the California court's decision to superimpose class action procedures onto the arbitration proceeding because, in the absence of such procedures, the entire arbitration agreement could have been struck down as "unconscionable." (*See* Appellees' Br. 38-41, 14 n.10.) They argue that such a decision would be consistent with Section 2 of the Federal Arbitration Act, which permits courts to invalidate an arbitration agreement "upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. This contention is untenable.

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[26] *See also National Mutual Ins. Co. v. Tidewater Transfer Co.*, 337 U.S. 582 (1949) (upholding constitutionality of diversity jurisdiction under 28 U.S.C. § 1332 as applied to state-created substantive rights).

Appellees have not identified any provision in the 7-Eleven arbitration agreement that is even arguably unconscionable as applied to their claims in this litigation. The contract provides for the selection of neutral arbitrators and specifies that the rules of the American Arbitration Association shall be followed. The arbitration proceedings in this case would proceed in the same manner as the thousands of other commercial arbitrations that take place each year.[27]

Appellees' "unconscionability" argument, which challenges the arbitral process itself rather than any particular defect in the agreement between the parties to this case, exceeds the narrow scope of the proviso in Section 2 of the Federal Arbitration Act. As this Court recently held in *Moses H. Cone Memorial Hospital*, courts must enforce arbitration agreements even though they might believe that some other procedure would be more efficient and equitable. *See* 103 S. Ct. at 939. (*See also* authorities cited in Appellants' Br. 40-41.) If judges were free to strike down arbitration clauses on the basis of the vague "fairness" principles that appellees propose, arbitration would be thrown back to the vagaries which existed before the federal statute was enacted and which it was the law's express purpose to remedy.

Appellees raise the spectre of unrighted wrongs in the absence of class action arbitration procedures. (Appellees' Br. 39.) However, as noted in Southland's opening brief, the appellees in this case have never alleged that they would be unable to prosecute their claims without a class action, and there is no objective evidence that

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[27] In 1981, the American Arbitration Association (AAA) handled 7,371 new commercial arbitrations alone; in 1982, the AAA dealt with 7,465 additional commercial cases. *1981-1982 Annual Report of the American Arb. Ass'n* 7; *1982-1983 Annual Report of the American Arb. Ass'n* 7. Arbitration by the AAA of other types of disputes is also extensive: in 1982 alone, the AAA processed 14,156 new accident-related arbitration claims and 17,038 labor-related claims. *Id.*

normal arbitration procedures have been inadequate in other cases. (*See* Appellants' Br. 39 n.52.) Moreover, appellees' argument overlooks the fact that arbitration *facilitates* the prosecution of small claims by providing a quick, informal, inexpensive alternative to costly court proceedings. (*Id.* at 39.)

2. *Class Action Arbitrations Would Substantially Impair the Federally Protected Right To Enforce Arbitration Agreements*

Appellees mischaracterize the issue when they describe the class action issue as a mere question of "procedure." (*See* Appellees' Br. 41-43.) Arbitration is a procedural device; but the Federal Arbitration Act goes beyond this and creates a substantive federal right protecting this procedure. Therefore, when a state attempts to alter that procedure by turning an informal, nonjudicial device into one that is complex and judicially controlled, the effect can only be described as a *substantive* interference with the federally protected right of arbitration.

It is true, of course, that the states can ordinarily apply their own procedures in their judicial proceedings relating to arbitration. (*See* Appellees' Br. 42-43.) For example, if a party files an action in state court to compel or to stay arbitration proceedings, the state court's normal rules regarding docketing fees, service of process, form of applications to the court, etc., will govern. However, the right to control *judicial proceedings* relating to arbitration does not create a license for the state courts to turn the arbitration itself into a judicially controlled procedure, for this would destroy the very essence of arbitration. This Court has often noted that state judicial procedures cannot be permitted to interfere with federal substantive rights.[28] And, with regard to arbitration in

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[28] *E.g.*, *Brown* v. *Western Ry.*, 338 U.S. at 296 (a "federal right cannot be defeated by the forms of local practice"), 299 (" 'the assertion of federal rights, when plainly and reasonably made, is not to be defeated under the name of local practice' ").

particular, this Court recently stated in *Moses H. Cone Memorial Hospital* that the states cannot interfere with the "liberal federal policy favoring arbitration" by the use of "any . . . substantive *or* procedural" policies. 103 S. Ct. at 941 (emphasis supplied).[29]

Notwithstanding appellees' feeble protestations to the contrary (*see* Appellees' Br. 46-49), it is beyond dispute that a "class action arbitration" would be radically different than a normal arbitration proceeding and would require substantial, ongoing, affirmative obligations on the part of a court. The procedure would be decidedly more formalized, time-consuming, expensive, and judicially controlled than arbitration as it now exists. (*See* Appellants' Br. 32-42.)[30] Indeed, given the added complexities that would be caused by the overlapping responsibilities of the

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[29] Appellees miss the mark when they attempt to analogize class action arbitrations to situations in which some lower courts have *consolidated* two separate arbitrations involving a common set of facts and three parties (*e.g.*, X initiates an arbitration with Y and Y files an arbitration demand against Z in a single contractual dispute). The propriety of such consolidations is unsettled. (J.S. App. 42a.) More importantly, consolidation merely brings several parties into one proceeding so that their mutually interdependent rights and liabilities can be adjudicated at one time. It did not appear in any of the cases cited by appellees (Appellees' Br. 44-45) that consolidation would increase the duration or cost of the proceeding, or pose manageability problems such as those presented by class actions, or interfere with the ability of the arbitrators to conduct the proceedings as they saw fit. The courts in those cases were able to make a clear-cut, one-time decision whether the arbitrations should go forth separately or together, and could thereafter divorce themselves from the conduct of the proceedings. Moreover, in the consolidation setting—unlike a class action—each party is personally represented rather than being forced to rely on the hope that someone else will adequately protect his interests.

[30] For instance, appellees are clearly wrong when they suggest that a class action would not require active judicial involvement. (Appellees' Br. 48.) Federal constitutional considerations of due process require careful judicial oversight at all stages of the proceedings. (*See* cases cited in Appellants' Br. 34-37.)

arbitrator and the court, it is difficult to imagine why parties would subject themselves to such a procedure. They would almost certainly opt for the "simpler" judicial class action, thereby circumventing the arbitration agreement as a direct result of the court-mandated procedures. We submit that this Court should not countenance such a result.

Respectfully submitted,

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